

**BEFORE THE PUBLIC UTILITIES COMMISSION  
OF THE STATE OF CALIFORNIA**



**FILED**

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In the Matter of the Application of SAN GABRIEL VALLEY WATER COMPANY (U337W) for Authority to Increase Rates Charged for Water Service in its Fontana Water Company Division by \$5,662,900 or 13.1% in July 2006; \$3,072,500 or 6.3% in July 2007; and \$2,196,000 or 4.2% in July 2008.

Application 05-08-021  
(Filed August 5, 2005)

Order Instituting Investigation on the Commission's Own Motion into the Rates, Operations, Practices, Service, and Facilities of San Gabriel Valley Water Company (Utilities 337 W).

Investigation 06-03-001  
(Filed March 2, 2006)

**CITY OF FONTANA'S COMMENTS ON ADMINISTRATIVE LAW JUDGE  
BARNETT'S PROPOSED DECISION**

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**February 26, 2007**

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Pursuant to Rule 14.3 of the Commission's Rules of Practice and Procedure, the City of Fontana respectfully submits its comments on Administrative Law Judge Barnett's proposed decision issued on January 29, 2007. The City of Fontana appreciates the attention and thought displayed in the proposed decision. The City also appreciates the offering of mediation services by the Administrative Law Judge Division regarding recycled water issues. The City will address a few points in the proposed decision for further consideration. Specifically, the City will address the following general issues as they relate to findings and conclusions in the proposed decision: the facilities fee; San Gabriel Valley Water Company's proposed projects under its water master plan in general and its Sandhill project in particular; the Company's prior projects constructed since 2002; the Company's record keeping; the Water Division audit report; and the issues of penalties and the cost of capital.

1. FACILITIES FEE

One of the key issues regarding San Gabriel's proposed capital program was the degree to which it was growth driven. The proposed decision states that the Fontana Division faces significant growth, which in turn will generate greater demand for water and accompanying infrastructure. (See, e.g., Finding of Fact No. 34.) The City suggested that current ratepayers should not in effect subsidize future consumers of water. In other words, infrastructure that is growth driven by new connections is by definition not caused by current ratepayers and the cost of that growth should be shifted away from current ratepayers.

The City proposed that a capital facilities fee be used here in a manner similar to what most local communities do—require new connection fees to be paid upon development by the developer. San Gabriel ultimately did not oppose the concept. Both the proposed and alternate proposed decisions endorse the concept. The City is pleased that both Judge Barnett and Commissioner Bohn agree with the concept in principle and appreciate the thought they have put to the mechanics of implementing the concept.

The City does have a few concerns, however. Specifically, proposed Finding of Fact No. 66 suggests that the revenue that a facilities fee “would generate is highly uncertain in both amount and in timing.” This finding suggests that for this reason the facilities fee revenue

should be taken into account through advice letter after the fees are received. In other words, there is to be no initial rate adjustment (presumably downward) because of the facilities fee.

The concern is that proposed Finding of Fact No. 1 adopts San Gabriel's projection that active service new connections will increase at a rate of 1350 per year. This projection is not deemed too uncertain for revenue projections. To be consistent, this projection should be used for calculating the facilities fees. Exhibit 62a sponsored by the Division of Ratepayer Advocates, the City, and the Fontana Unified School District accounts for the facilities fee based upon the 1350 connections projection. Consistency would seem to require that the rates be accordingly adjusted to account for the facilities fee based upon the finding of fact that projects a specific number of connections. If an advice letter approach is to be used instead of making the rate adjustment initially, at a minimum the adjustments should be guaranteed to be concurrent to pass any benefits to ratepayers immediately for offsetting rates and rate base.

2. PLANT ADDITIONS AND SAN GABRIEL VALLEY WATER COMPANY'S  
WATER MASTER PLAN

In the prior rate case, the City was critical of San Gabriel for failing to do water master planning and for in fact being disdainful of such planning. As a result, the Commission ordered San Gabriel to prepare a master plan. San Gabriel presented this plan in this proceeding. In this proceeding DRA, the City, and the District were critical of certain aspects of this master plan. The City will not repeat the details of its prior briefing, but the record unequivocally demonstrates that the master plan contains major deficiencies, exaggerating existing demand and understating existing supply, in order to justify an ambitious capital program. See, e.g., pgs. 2-5 of City's March 26, 2006 Brief, and March 26, 2006 Brief of Fontana Unified School District. Given that San Gabriel proposed a four year \$89,000,000 capital budget when it estimated the pre-existing rate base was around \$70,000,000, the City was particularly concerned that ratepayers would be saddled with a monstrous burden of paying rates based on facilities that were not currently needed and which according to the master plan itself would not be needed for decades to come.

The proposed decision states at page 33 that it does not “endorse every aspect of the Master Plan.” Ultimately, the proposed decision adopts the 10% rate base cap adopted in the prior rate case decision. Proposed Finding of Fact No. 42 adopts this approach and concludes: “We are not disposed to dictate to San Gabriel which plant will be constructed in which order; that is a management decision.” Page 33 of the proposed decision states “We will resolve ‘used and useful’ issues in its next GRC, at which time a major concern will be whether the Company has maximized its efforts to obtain contributions from developers and others to pay for plant needed to meet growth.” This specific reservation is not reflected in the proposed findings or order.

In the prior rate case the City was concerned about the rate base cap approach and whether it bypassed the Commission’s rate review obligations and the Company’s burden of proof for project and rate justification. The City pursued an application for rehearing, joined by DRA and the District, which was granted in part. See, e.g., City of Fontana’s July 29, 2004 “Application for Rehearing and Reconsideration of Decision 04-07-034.” In its decision resolving the rehearing, the Commission in June 2006 stated the Commission would still review whether any facilities constructed since 2002 were justified. D. 06-06-036. (This review will be discussed in the next section.) In other words, further review would be provided thereby addressing the concerns of the application for rehearing. By this approach, the Commission would still retain its review responsibilities in accord with the requisite burden of proof imposed by statute and case law.

The proposed findings in the proposed decision appear to authorize San Gabriel to build any master planned facilities if within the 10% rate base cap, even though the proposed decision simultaneously says it does not fully endorse the plan. The City’s prior concerns about the Commission’s review obligations and the Company’s burden of proof raised in the prior proceeding potentially apply under these circumstances. The City requests that the proposed findings and order reflect that any increases in rate base under the cap be specifically subject to review in the next GRC.

Such a proviso is particularly pertinent in light of the facilities fee determination and the proposed findings that the “Fontana Division is confronted with increased demand throughout its

service area as the result of rapid new growth.” Proposed Finding of Fact No. 33. Review will have to be undertaken, as the proposed decision acknowledges, concerning the Company’s efforts to obtain contributions from developers. The adoption of the facilities fee represents a sound decision that current ratepayers should not pick up the financial burden of future development caused by others. The projects constructed under the cap should be subject to review for that and other purposes and the City urges that the proposed findings should reflect that requirement in order to minimize legal issues that a rate base cap approach may otherwise raise.

The City believes this is particularly true with regard to the Sandhill project. It is a massive multi-million dollar project, that has gone from its prior configuration as a \$9.8 million project to a \$35,000,000 project, a point acknowledged by the proposed decision. What the record establishes is that San Gabriel’s master plan indicates that Sandhill when completed will cost \$77,000,000—a doubling of the pre-existing rate base in this rate case. See, e.g., pg. 269-71, Ex. 13 (the master plan’s proposed costs for Sandhill are summed up in the District’s March 26, 2006 Brief, p. 9-10). What the record further establishes is that Sandhill’s purported rationale for Sandhill has shifted and that the Company’s witnesses repeatedly stated it was not aimed at addressing peakday demand in summer but rather taking advantage of surface flows in the winter/spring months. See, e.g., RT v. 2, 207/17-19. (San Gabriel/LoGuidice). At the same time, San Gabriel’s own engineer witness responsible for the water master plan acknowledged that the need for Sandhill was largely future development driven. San Gabriel/Johnson RT v. 2, 90/1-17. Under these circumstances, the City believes that it would be legal error not to have expenditures for Sandhill expressly subject to further review as to justification for any inclusion in rate base, especially given the issue of facilities fees and developer contributions. Accordingly, the City does agree with the proposed decision that advice letter treatment for Sandhill is inappropriate.

### 3. REVIEW OF PROJECTS CONSTRUCTED SINCE 2002

As previously discussed, the prior rate case initiated the 10% rate base cap approach. The City filed an application for rehearing challenging that approach if it meant no reasonableness review of projects and rates in accord with the required burden of proof imposed

on utilities by law. The application for rehearing was granted in part. The City (joined by DRA and the District) expressed its concerns that the review duties of the Commission and the Company's burden to justify projects were being bypassed. The Commission issued on June 15, 2006 a decision that addressed these issues after the current evidentiary hearings had closed. D. 06-06-036. That decision in pertinent part stated:

"We need not authorize specific projects. The construction budget, and rate base, will get a third review in the current GRC, A. 05-08-021. In that third review, we will have the opportunity to determine the reasonableness of what actually has been constructed since 2002. To the extent that construction was unneeded, it will be found to be unjustified and therefore unreasonable. Because current rates are subject to refund, any finding in this rehearing. The difference is palpable: rather than forecasting that a project is or is not necessary, we have the benefit of hindsight to review whether the project was, in fact, needed. This is the lesson of all rate cases which are based on a forecast year." Pg. 9 of Commission web version of decision.

That review has not taken place.<sup>1</sup> The proposed decision has no findings in this regard

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<sup>1</sup> In its June 5, 2006 comments on the quote above in the proposed decision, the City said the following:

"Frankly, the City sees this approach as the only potentially conceivable way to survive the City's objections and to reconcile the Commission's earlier determinations that San Gabriel failed to meet its proof obligations.

"There is one major problem with this approach, however. The City, indeed none of the parties, was on notice that projects constructed pursuant to the rate base cap were subject to this review in the current rate case proceeding. The City, the District, DRA, and San Gabriel did not address whether projects constructed since 2002 were justified. The scoping memo does not address this issue. October 20, 2005 Scoping Memo. Neither does the record in the proceeding. In fact, based on that record, the Commission would be compelled to find any such constructed projects were not justified.

"The City suggests that the only conceivable way the rate base cap could possibly survive legal review is by the approach suggested in the draft decision [on the limited rehearing concerning whether San Gabriel met its burden of proof on its projects, which became D. 06-06-036]. It also suggests that the only way this approach can be appropriate is by re-opening the hearings so that the parties can address whether the projects constructed since 2002 were justified." Pg. 3-4 "City of Fontana's Comments on Draft Decision re Opinion on Limited Rehearing of Decision 04-07-034." The Fontana Unified School District joined in these comments.

DRA also stated it was unaware that such a review was to be undertaken in the current rate proceedings, a point acknowledged by the D. 06-06-036 and noted that the City and the District made the same point. The Decision (p. 28 mimeo) responded:

with respect to projects constructed since 2002. It cannot because this was not a topic of the evidentiary hearings, which were completed before this decision on the rehearing was issued. The scoping memo does not specify that projects constructed since 2002 were subject to reasonableness review. The record does not provide any basis for determining specifically what projects were constructed since 2002 and whether they were needed. The City submits that the evidentiary hearings must remain open to comply with D. 06-06-036 and proceed with this review. Otherwise legal error will result affecting this and the prior consolidated proceedings.

#### 4. SAN GABRIEL VALLEY WATER COMPANY'S RECORD KEEPING

The issue of San Gabriel's record keeping practices arose in the context of its handling funds from third party sources. In the prior rate case, the City made a motion for an audit of the Company's receipt and expenditure of what were called condemnation funds. The Commission granted the motion. The Water Division prepared its audit report, which is in the record as Ex. 63. The report, among other things, found fault with the Company's record keeping practices. The proposed decision does not, and even expresses puzzlement over the positions of DRA, the City, the District, and the Water Division on some of these issues. Pg. 104 of proposed decision.

The City believes that the record shows that San Gabriel engaged in improper record keeping and that it is legal error to find to the contrary. The City will not repeat the details of its briefing but will point to certain points in the record that cannot be seriously contested and which demonstrate improper record keeping by San Gabriel.

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"Rate base issues were left open in D. 04-07-034 to be resolved in A.05-08-021. We are reviewing D.04-07-034 based solely on its record. We are not reviewing A.05-08-021 and the issues raised, or which might be raised in that proceeding, DRA's request is premature and, therefore, denied."

The City respectfully suggests that the request can no longer be considered premature when the proposed decision proposes to close all proceedings. In fact, there is no need to make a request. This decision expressly stated such a review would occur. The fact remains it has not. Review must proceed in this proceeding or alternatively the Commission must find there is no basis to conclude that projects constructed since 2002 were reasonable and needed.

San Gabriel asserted that the \$27,000,000 at issue in the audit report essentially represented gains from real property sales. At the same time, its own accounting expert and former auditor, Mr. Snow, prepared an exhibit taken from the audited financial statements and testified that these records indicated approximately \$4,000,000 in property sales proceeds. Snow/San Gabriel, RT v. 6, 534/18-535/12. This at least demonstrates inconsistency in how such proceeds were reported, an inconsistency that has never been explained.

Mr. Batt, San Gabriel's chief financial officer, testified that no Section 790 proceeds were used to fund affiliate transactions. San Gabriel Ex. 6, p.3/8-9. This was contradicted by a memorandum prepared by Mr. Nicholson, vice president of San Gabriel in charge of real estate. When San Gabriel purchased property from Rosemead in a transaction that the proposed decision properly calls egregious, a memorandum was sent to management that this acquisition should be considered a transaction under Section 1033 of the Internal Revenue Code and under Section 790 of the California Public Utilities Code. Ex. 48 at 3B. Mr. Nicholson explained that this was simply a "standard form memo" used for all real estate transactions. San Gabriel/Nicholson. RT v. 3, 291/13-292/1. In other words, this "standard form memo" appears to be used regardless of circumstance.

Mr. Dell'Osa, director of rates for San Gabriel, testified that monies the Company purported to be subject to Section 790 were not put in a memorandum account in accord with the California Water Company decision. D.04-07-033. San Gabriel/Dell'Osa. RT v. 6, 585-588/10. He testified they were not because he did not understand the decision's reference to "memorandum account fund". He further testified he never sought guidance on the issue. San Gabriel/Dell'Osa. RT v. 6 593/26-594/11. There never was any on-going effort to track money San Gabriel claimed was subject to Section 790. Id.

Mr. Batt's accounting of reinvestments of supposed 790 proceeds were prepared in some cases years after-the-fact. They were based simply on the timing and then the after-the-fact assertion these monies were invested in a particular job. They could just as easily have been stated to have been in some other job. See, e.g., RT v. 6, 575/3-9 (San Gabriel/Batt); 571/28-573/16 (San Gabriel/Dell'Osa).

The proposed decision does not necessarily agree with San Gabriel's accounting of dividends and finds it could have handled the issue more appropriately. (Pg. 91-92.) It essentially finds that ratepayers were not harmed and therefore the issue of dividends is a non-issue. Pg 92. The fact remains that San Gabriel recordkeeping obscured what occurred. For example, a \$4.9 million dollar special dividend was paid that coincided with receiving a comparable amount in payment toward the settlement with San Bernardino County. San Gabriel refused for years to divulge what the purpose of this special dividend payment was. In the last day of the evidentiary hearings it revealed it was to loan money to a shareholder in the parent company for estate taxes. Ex. 80. Accordingly, the City respectfully requests that the first sentence in proposed finding of fact 82 be omitted.

##### 5. WATER DIVISION AUDIT REPORT

With the exception of the findings concerning record keeping, the City generally agrees with the proposed decision's legal analysis concerning the Section 790 and condemnation funds issues. It does, however, believe that existing Commission precedent asserts that one hundred percent of contamination settlement monies be returnable to ratepayers. Southern California Water Company D. 04-07-031; 2004 Ca. PUC LEXIS 368.

There are good reasons to stay with precedent. First, water utilities already have an incentive, and in fact a duty, to pursue polluters. They have a legal obligation to provide safe and reliable water to its customers. Second, ratepayers truly are at full financial risk. Undoubtedly if a plant were to close due to contamination, water utilities would use that as a basis for seeking and obtaining rate increases to replace or fix the plant. It is also the ratepayers that face the real consequences if a plant shuts down due to contamination. On the other hand, the utilities potentially may still receive revenues based upon a rate of return on plant that is actually not functioning. Third, there is a legal perversity in having a utility being better off if plant is damaged by contamination than if it is not. In fact this may create the wrong incentives to maximize claims for shareholder advantage instead of pursuing immediate solutions that benefit ratepayers and water service. At the same time, as a matter of law an award of damages is supposed to be based on actual damage, which presumably is measured by the economic impact to the facilities and its operations. If a percentage of that award is given to the utility, the

ratepayers are being short-changed. Fourth, the principle that water utilities should not make a profit from pollution is also recognized by the Commission in other contexts. When utilities seek grants for contamination treatment, the Commission does not authorize the utility to retain a large (or any) percentage of the grant as an incentive to seek such grants.

Here there is an additional compelling reason for following the 100% return to ratepayer principle. San Gabriel's conduct. It took a motion, an impartial audit, expert testimony, extensive discovery and cross-examination, and serious resources and energy to overcome San Gabriel's resistance to find out how San Gabriel got the money it did, how much it got, and what it did with it.

#### 6. THE ISSUE OF PENALTIES AND THE COST OF CAPITAL

Both the proposed and the alternate decisions are very critical of San Gabriel's practices and in particular find its handling of the Rosemead affiliate transaction egregious. The City agrees. It appears that the principal difference between the two decisions is whether \$40,000 or \$60,000 should be imposed. The proposed decision pointedly states that the Commission has been misled by San Gabriel and that San Gabriel is "no stranger" to such practices. The proposed decision also focuses on the importance of deterring bad utility practices. It, however, seems to convey the position that it is constrained by statute on the maximum amount that can be assessed for penalty purposes. Whether the penalty is \$40,000 or \$60,000 is not of grand consequence. What is of grand consequence is that San Gabriel has been found to have engaged in egregious practices intended to mislead the Commission and bring profit to the Company at ratepayer expense. Despite the blistering prior opinions of the Commission when San Gabriel has been caught, San Gabriel repeats itself, and the penalty, whether \$40,000 or \$60,000 is not commiserate with the totality of San Gabriel's conduct, which the proposed decision itself seems to acknowledge.

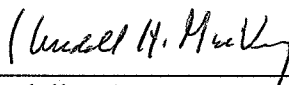
In truth, the Commission is not limited to the statutory fines. The Commission has made it clear that the rate of return on equity may be reduced due to bad management practices. See, e.g., Hillcrest Water Company (D. 97-09-059); California Water Service (Salinas District D.04-07-033); Southern California Water Company (D. 06-01-025). The proposed decision should

assess that alternative. Given the well justified findings in the proposed decision, it is almost compelled to do so.

Respectfully submitted,

Date: February 26, 2007

By:

  
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Kendall H. MacVey  
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City Attorney for City of Fontana

## APPENDIX

### The City of Fontana's Proposed Modifications to Proposed Decision

The City joins in the Division of Ratepayer Advocates' comments and proposed modifications of the proposed decision to the extent they are compatible and consistent with the City's comments. The City offers the following proposed modifications pursuant to its preceding comments.

#### 1. FINDINGS OF FACT

The City proposes deleting No. 39.

The City proposes adding to the end of the paragraph in No. 42: "Any projects constructed pursuant to the 10% rate base threshold shall be subject to review for reasonableness and San Gabriel's efforts to obtain contributions from developers."

The City proposes replacing No. 66 with the following:

"The facilities fees, and resulting impact on rates, shall be calculated based upon the projected connections in finding of fact No. 1."

The City proposes for No. 76 that the second to last sentence after "gain" read: "100% to ratepayers in accord with Southern California Water Company D. 04-07-031."

The City proposes for No. 82 to delete the first sentence and "however," from the second sentence.

The City proposes to add at the end of No. 88: "However, the Commission does have under such circumstances the authority to reduce the rate of return on equity. It shall do so by 50 basis points."

Order

The City proposes to modify paragraph 8 as follows: "Application 05-08-021 shall remain open to conduct a reasonableness review of projects constructed since 2002 as provided for in D. 06-06-036."

## CERTIFICATE OF SERVICE

I, **Frances A. White**, hereby certify that I have this day served a certified copy of the foregoing document: **CITY OF FONTANA'S COMMENTS ON ADMINISTRATIVE LAW JUDGE BARNETT'S PROPOSED DECISIONS**

on all known parties to the service list **Application 05-08-021 and Investigation 06-03-001**; I caused the documents to be sent to the persons at the e-mail addresses listed below. I did not receive, within a reasonable time after the transmission, any electronic message or other indication that the transmission was unsuccessful.

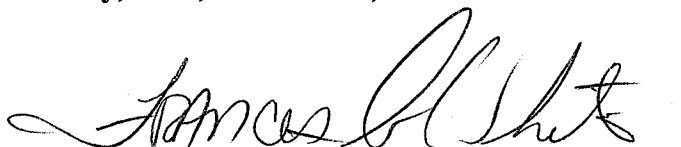
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rac@cpuc.ca.gov; rab@cpuc.ca.gov; nat@cpuc.ca.gov; flc@cpuc.ca.gov; jll@cpuc.ca.gov; kok@cpuc.ca.gov; dlh@cpuc.ca.gov; james\_peterson@feinstein.senate.gov; bda@cpuc.ca.gov;

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Executed this 26 day of **February, 2007**, in Riverside, California.

  
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**Frances A. White**